

MUNICIPAL SERVICES AND INFRASTRUCTURE ASSESSMENT FOR CROATIA

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SUMMARY

Objective of the Assessment

This assessment of the municipal sector in Croatia, prepared in conjunction with the four Croatian cities of Zagreb, Split, Rijeka, and Osijek, examines municipal services and infrastructure for the United States Agency for International Development (USAID). The assessment outlines current conditions and identifies key issues to be addressed in reforming and improving performance in the municipal sector, consistent with USAID's objectives and strategies for Croatia and the region.

General Context

The decentralized political system in Croatia has given considerable responsibility to cities for infrastructure development and operation, areas identified as priority areas by the local authorities. Along with the more general problems associated with a transition to a market-oriented economy that Croatia faces, the war has exacerbated existing problems in the urban sector by diminishing available central support and increasing population pressures from refugees and displaced persons.

Despite extensive experience with decentralization, many elements of autonomy are still missing, along with incomplete legislation and uneven taxation powers. Strengthening city governments in Croatia would foster decentralization. Stronger cities could provide needed services to help stabilize the society and would also create a viable center of power other than the national government, thus aiding in democratization.

Legal Framework

The Constitution of the Republic of Croatia establishes the right to local self-government.

The Law on Local Self-government regulates all the forms of local self-government: municipalities, cities and counties. The exception is the capital city of Zagreb, which is a combined city-county government and has its own statute to regulate its operations. Types of local government are defined and powers and duties are specified for counties, cities and municipalities. The structure of all units of local government are regulated by this law and include an elected Mayor (or County Executive), an elected City (or County) Assembly, an executive council and administrative departments. In addition, the law provides for direct participation of citizens in local government, including the right to propose legislation, the right to referendum and provisions for citizen organizations. There is also a specific provision in this law for a formal national association of units of local self-government that is a legal entity. This association does exist in Croatia, but is not active and is viewed as heavily influenced by the ruling party.

The Law on Financing Local Self-Government regulates the financial sources of counties, cities and municipalities. Revenues include taxes, revenues from city property, fines, utility and other fees, and other revenues established by special act. Cities with more than 40,000 inhabitants can introduce an income tax surcharge to finance operations. This law also regulates the preparation of the city budget and establishes the authority of cities to issue bonds with the approval of the Ministry of Finance.

Current System for Financing Capital Projects

There is currently little financing of any local capital improvement projects in Croatia. The resources for financing infrastructure are fees, transfers from the city budget (for utilities), financing from companies building the infrastructure and loans. If the infrastructure is of regional interest, the national government will finance construction of the facility through the national companies (Water Management Company, Croatian Roads Company), often by getting foreign loans.

Municipal Bonds and the Capital Market

Most banks are not involved in financing infrastructure through long term loans or bonds, but there is a growing awareness in the banking sector of the possibilities for financing infrastructure through the use of municipal bonds.

The Croatian banking system includes a National Bank, the Croatian Credit Bank for Reconstruction and Development, the Ministry of Finance, an Association of Banks and Commercial Banks, and Savings, Mortgage and Housing Banks.

In addition to accessing capital through domestic bank loans supported by the national government and foreign development bank loans, some local governments are working with local banks to issue municipal bonds.

The County of Istria is the first and only unit of local government to issue bonds. These bonds were issued in December, 1994. These bonds were issued to finance a portion of the development of a waste treatment plant in the City of Pazin.

There are several brokerage firms being formed that are encouraging banks, local governments and the national government to use municipal bonds as a way of financing infrastructure.

In June of 1996, the brokerage firms of CORA and FIMA presented the Association of Banks a study entitled "On Issuing Bonds of the Republic of Croatia for Economic Development". This study was discussed in a meeting of the Association, approved and sent to the Ministry of Finance for favorable consideration. The study discusses the advantages of bonds and ways to make them a more secure and thus more marketable investment.

City Assessments

Each of the four focus cities are described in terms of their general context, city infrastructure, organization and structure, budget and finance, and priority concerns.

Priority concerns for the City of Zagreb are housing and municipal management. Municipal management concerns include the improvement of administration, improvement of political decision-making, more effective land use policy, legislative reform, information system improvements, intergovernmental relations, privatization of city services, capacity building of the city workforce, protection of the city water supply and wastewater improvements.

Priority concerns of the City of Osijek are the wastewater system and solid waste disposal.

Priority concerns for the City of Split are wastewater improvements and housing.

Priority concerns for the City of Rijeka are wastewater treatment, solid waste disposal, and gas pipeline construction.

All of the cities indicated an interest in new ways of financing infrastructure, improved management and a stronger voice for local governments in national affairs.

Recommendations

A program of assistance to these large cities is recommended, focused on creating a stronger voice for city government and strengthening the cities abilities to provide needed services.

The general strategy recommended for strengthening local governments in Croatia is designed to achieve the following strategic objectives:

1. Strengthen local government to be accountable, responsive and effective.

Supporting democratic processes in the larger cities of Croatia will contribute to creating centers of democratic power beyond the central government. Specific improvements include better municipal services, economic development, better management of resources and greater accountability through effective and participatory decision-making processes. Longer term sustainability is sought through:

- a. the establishment of institutional and legal frameworks
- b. the development of Croatian capacity in technical support services
- c. strengthening communication and collaboration among cities
- d. the creation of viable models and examples of improved management and service delivery.

2. **Integration and development of Sector East.** The program should seek to leverage local and foreign resources to begin the reconstruction process, while helping establish management and decision-making processes that can deliver desired services for citizens. The program can help negotiate a common agenda between the exiled and current governments by focusing on concrete and tangible improvements. Integration can be fostered by the re-introduction of Croatian legal and political systems, and strengthening communication among cities.

The general strategy recommended is as follows:

1. Focus on Zagreb, Split, Osijek and Rijeka, the four largest cities in Croatia. Because of their size and importance, they will have substantial impact on the Croatian development and have greater capacity to impact national policy and institutions. In addition, the cities of Varazdin and Vulcovar can be included to further the strategic objectives.
2. Foster information sharing among cities in Croatia to build an advocacy voice for local governments and maximize the use of regional experience and internal experimentation and innovation.
3. Establish partnerships and collaborative relationships with each city to ensure full commitment in design and implementation.
4. Build sustainability while being cost effective by using local consultants and institutions.
5. Focus on priority issues of high interest to the cities to provide tangible results that can lead to longer term rewards from a partnership.
6. Leverage local and foreign technical and capital resources to accomplish project goals. Use experience and materials already developed in Croatia and throughout Eastern and Western Europe and other places, as appropriate. Access capital from local and foreign sources, including World Bank, European Union and other funding sources active in Croatia.
7. For Sector East, the strategy should focus on building interaction by sharing information, delivering tangible results while working on longer term issues, and assisting in re-introducing political and institutional systems common to Croatia.

The opportunities for effective collaboration and technical assistance with Croatian cities are substantial. The cities are interested in working with USAID and would benefit by the technical assistance that USAID can offer.

MUNICIPAL SERVICES AND INFRASTRUCTURE ASSESSMENT FOR CROATIA

OBJECTIVE OF THE ASSESSMENT

In conjunction with the four Croatian cities of Zagreb, Split, Rijeka, and Osijek, the Contractor was asked to prepare a sector assessment examining municipal services and infrastructure for the United States Agency for International Development (USAID). This assessment of the municipal sector outlines current conditions and identifies key issues to be addressed in reforming and improving performance in the municipal sector, consistent with USAID's objectives and strategies for Croatia and the region. The recommendations will provide background for the USAID resident advisors implementing the Municipal Management Program in Croatia.

GENERAL CONTEXT

USAID is providing assistance focused on policy and institutional development in the urban development sector in Central and Eastern Europe as part of the East European Regional Housing Project (EERHP).

The decentralized political system in Croatia has given considerable responsibility to cities for infrastructure development and operation, areas identified as priority areas by the local authorities. Along with the more general problems associated with a transition to a market-oriented economy that Croatia faces, the war has exacerbated existing problems in the urban sector by diminishing available central support and increasing population pressures from refugees and displaced persons.

Despite extensive experience with decentralization, many elements of autonomy are still missing, along with incomplete legislation and uneven taxation powers--while taxation represents 92 percent of public finance in Zagreb, it forms only 8 percent in other towns. Many local governments remain heavily dependent on the central government. Police and public security is still centrally controlled, along with health care and education, and some utility provision.

The Republic of Croatia has a population of 4.78 million inhabitants. In 1991 there were 175,338 persons working abroad accompanied by 108,724 family members. This number increased significantly in the 1990s due to the war and post war conditions. At the end of 1995 the number of people employed was 1,161,657, and there were 243,324 unemployed. The unemployment rate in 1994 was 16.7 percent. Average monthly net pay (after taxes) for the period from January to September 1994 was 1800 Kuna (Kn) and gross pay was 2852 Kn. Industrial production in 1994 (change in relation to previous year) was negative (2.7%). Gross domestic product per capita in 1993 in current prices was US \$ 2,841, and in 1993 GDP real change in relation to the previous year was a negative (3.7%).

LEGAL FRAMEWORK

Several laws of the Republic of Croatia provide the legal framework for local governments:

The Constitution of the Republic of Croatia (*Narodne novine* No. 56/90) is the basic law of the nation. The Constitution establishes a right to local self-government, including the right to decide about the citizens' needs and interests at the local level.

The Law on Local Self-Government (*Narodne novine*, No. 90/92, 94/93, 117/93) establishes the authority and organization of local government.

The Law on the Territories of Counties, Cities and Municipalities (*Narodne novine*, No. 90/92) and the **Law on the City of Zagreb** (*Narodne novine*, No. 22/93) determine the area and authorities of local governments.

The Law on Financing Local Self-Government (*Narodne novine*, No. 117/93) defines the revenues and authorities regarding financing local governments.

The Law on Securities regulates the issuance, ownership and use of securities.

The discussion that follows highlights provisions of the Constitution and the two key laws implementing the local self-government provisions of the Constitution: the Law on Local Self-government and Administration and the Law on Financing Local Self-Government and Administration.

The Constitution of the Republic of Croatia

The Constitution of the Republic of Croatia was enacted by the Parliament (Sabor) on December 21, 1990. The values of the Republic are described in Article 3:

“Freedom, equal rights, national equality, love of peace, social justice, respect for human rights, inviolability of ownership, conservation of nature and the human environment, the rule of law and a democratic multiparty system are the highest values of the constitutional order of the Republic of Croatia.”

Section VI of the Constitution describes the Organization of Local Self-government and Administration. Article 128 states:

“Citizens shall be guaranteed the right to local self-government.”

The right to local self-government shall include the right to decide on needs and interests of local significance, particularly of localities and housing, public utilities, child care, social welfare, culture, physical culture, sport and technical culture, and the protection and promotion of the environment.”

Article 130 describes the autonomy and supervision of local government:

“Units of local self-government shall, in conformity with law and by-laws, be independent in the conduct of local affairs and shall only be subjected to the supervision of legality by competent bodies of the Republic.”

Decentralization of governmental functions to the local level is supervised by the Ministries of the national government.

The Law on Local Self-Government

This law regulates all the forms of local self-government: municipalities, cities and counties. The exception is the city of Zagreb, which is a combined city-county government and has its own statute to regulate its operations. The law on local self-government defines the forms of local government as follows:

A county is determined to reflect the historical and economic factors in determining its boundaries. There are 20 counties in Croatia; 21 if the combined city-county government of Zagreb is included.

A city is a self-government unit which is a natural economic and social unit. The city may encompass the suburban settlements which form the natural economic and social unity with the city related to the daily needs of its citizens. There are 70 cities in Croatia. Cities with more than 40,000 inhabitants can introduce an income tax surcharge to finance operations.

A municipality is a local self-government unit generally involving several residential areas that are natural economic and social entity, but with a population of less than 10,000. There are 426 municipalities in Croatia.

The scope of responsibility of a **county** is as follows (Article 15):

1. Coordinates interests and undertakes activities for the purpose of uniform economic and social development of cities and municipalities within the county.
2. Settles disputes among the cities and municipalities within the county.
3. Determines the conditions for the area arrangement and protection in the county.

4. Coordinates the development and network of the educational, cultural, medical, social, public utility services and other institutions, facilities and infrastructure.
5. Performs any tasks transferred to it from a municipality.
6. Establishes public institutions and other legal entities to achieve common aims shared by municipalities, cities and the county.
7. Regulates other matters of common interest for municipalities, cities, and the county.

The scope of responsibility of a **city** is as follows (Article 13):

1. Ensures the conditions for the development of economic, social, public utility and other activities and services, which are important to the city.
2. Ensures the conditions for zoning and planning and for the protection of the human environment.
3. Takes care of the quality of housing, public utility facilities, the performance of public utility and other services and local infrastructure.
4. Provides the following services: child care, education, public health, animal protection, social welfare, culture, sports and any other service not stipulated by law.
5. Manages municipal property.
6. Establishes public institutions and other legal entities to provide economic, social utility and other needs of the population.
7. Other duties as prescribed by law.

The structure of all units of local self-government is regulated by this law. The same basic structure applies to the municipality, city and county (See Figure 1).

The main difference between the city and the county is that the county has a significant portion of its organization devoted to State (national) functions. These local divisions of the national ministries are not subject to the direction of the County Assembly or the County Executive. These functions report directly to their respective Ministries. The State function of the county is significantly larger than the local self-government function (See Figure 2). For example, the county of Split has 50 employees dedicated to the local self-government function; it has 800 employees dedicated to its State functions.

The primary structure of a city government are as follows:

1. **Elected Representative Body**

The City Assembly is elected (through a complicated process described in a separate law on elections) for a four year term. The Assembly has a Chairperson and two Vice Chair people. The Assembly passes its decisions by a majority vote of a quorum of the body. The number in the City Assembly is proportional to the city population, with no less than 20 and no more than 50 members (Article 50).

The role of the City Assembly is to (Article 49):

- A. Pass city statutes, decisions, and general acts.
- B. Elect and dismiss the mayor, the deputy mayor, the Executive Council, appoint working bodies of the Assembly and appoint and dismiss other persons under the by-laws of the city.
- C. Determine the structure and jurisdiction of city administrative bodies.
- D. Establish public institutions and other legal entities to perform economic, public, infrastructure and other tasks of interest to its citizens.
- E. Perform other tasks under its jurisdiction.

The law generally stipulates that the representative body can establish permanent and temporary committees and other working bodies, but does not prescribe which topics or forms these bodies must take.

Open voting is used at meetings of the City Assembly, "unless the representative body decides that secret voting is to be applied in certain issues" (Article 25).

2. **The Mayor**

The mayor represents the city and has executive power (Article 54). There is also a deputy mayor to act in the absence of the mayor.

The mayor is responsible for the performance of all State (national) tasks transferred to the jurisdiction of the city and all the tasks associated with local self-government.

3. *The Executive Council*

The Chairperson of the City Assembly nominates the members of the Executive Council and they are confirmed by the City Assembly. The members of the Executive Council are generally the department heads of the city. The mayor chairs the Executive Council. The Executive Council of a city is from 7 to 13 members (Articles 35,36, 37, 38 and 39).

4. *Administrative Departments*

Administrative departments are established to carry out the service functions of a city (Article 56). The organization of the departments and personnel policies are governed by a general act passed by the City Assembly.

The City Assembly can remove by a vote of no confidence the Mayor, the Deputy Mayor and the Executive Council (Article 39). If the City Assembly does not appoint a new Mayor, Deputy and Executive Council within 15 days, the Mayor can dissolve the City Assembly (Article 40).

The law on local self-government also provides for **direct participation of citizens** in decision making. Citizens can participate directly in making decisions on local matters by means of a referendum. (Article 17). Citizens are entitled to propose to the City Assembly that it adopt certain laws or deals with a certain issue. (Article 19) Local committees are established as a means of direct participation of citizens in decision making at the local level (Articles 57, 58, 59).

The City of Zagreb does not yet have any of these citizen organizations. It has divided the city into 21 neighborhoods and is drafting regulations governing the activities of these organizations.

Another significant feature of the law on local self-government are the provisions concerning **associations of cities**. Cities and municipalities may for the purpose of promoting mutual interests and improving cooperation establish national associations of local governments (Article 11). There is specific provision for a formal national association of units of local self-government that is a legal entity. This association does exist in Croatia, but is not active and is viewed as heavily influenced by the ruling party.

One of the significant issues in local self-government is to clarify the **role of the city and the county**. There is overlap of responsibility that causes confusion and competition between the city and the county. One notable area is land use. Both the city and the county are responsible for developing master plans for their areas. How these plans are coordinated is left undefined. The city cannot enforce many of its plans because all building permits and land use enforcement is the responsibility of the county, in its State function, not in its local self-government function.

The law on local self-government was adopted in 1992 and is under **consideration for revision**. The Ministry of Public Administration is drafting the law and it should be available for review in about a month. The draft of the new law is over 300 articles; it creates 10 new municipalities and details the labor relations provisions for the local government level. The city and the county governments are both interested in more favorable financing for local government. There are changes in the financial structure that would change the taxing system for cities and counties, but it is not clear that these changes would increase revenues at the local level.

There is also some consideration for strengthening the role of the city vis-a-vis the county. Some of the State functions currently performed by the county would be transferred to the city.

The proposed revisions have been reviewed with County Executives at a meeting of their association in February. There are no plans to review the draft with city officials. Once the law is proposed by the government to the Parliament, cities and others will have an opportunity to comment on it between first and second reading of the propose law.

The Law on Financing the Local Self-Government

This act regulates the financial sources and financing of counties, cities and municipalities.

Financial resources of a city or a municipality are as follows (Article 29):

1. Revenues originating from municipal and city property
2. Municipal and city taxes
3. Fines and seized property
4. Administrative tax pursuant to a special law
5. Residence tax pursuant to a special law
6. Utility fees, contributions and other fees established by special law
7. Fees for use of public property
8. Other revenues established by special act.

Municipal and city taxes are the following (Article 30):

1. Excise duty (on the consumption of alcoholic beverages in public inns)
2. Recreation (or vacation) houses tax
3. Public Displays (advertisements) tax
4. Firm and Corporate Name tax (similar to a registration fee)
5. Public Ground Utilization tax.

There are specific articles of the act that define the tax and often set an upper limit on its levy.

Common taxes include (Article 45):

1. *Income tax.* Income is shared by the State (nation), a municipality, a city and a county. The city or municipality receives 25% of the income tax; the county receives 5%. The City of Zagreb receives 45%.

A city with more than 40,000 population may levy an income tax surcharge up to 30%. The City of Zagreb may levy a surcharge of up to 60%.

2. *Profit tax.* Income is shared by the State (nation), a municipality, a city and a county. A city or municipality receives 20%; a county receives 10%.

3. *Hazardous Games tax (gambling).* Income shared by the State, municipality, and city. A city or municipality receives 50% of this tax.

4. *Real Property Sales tax.* Income shared by the State, municipality, and city. A city or a municipality receives 60% of this tax.

A county may levy the following kinds of tax (Article 5):

1. Inheritance and Donations (gift) tax
2. Motor Vehicles tax
3. Vessels (boat) tax
4. Entertainment and Sports Events tax.

County tax revenues may either entirely or in part be ceded to a city or a municipality in the territory of which a respective taxpayer resides (Article 28).

The act also regulates the preparation of the city budget (Article 52). The budget must specify all revenues and expenses of a city and must be balanced. In addition, the city must allocate an emergency reserve (Article 67) to be used for unforeseen circumstances and emergencies, or for revenue shortfalls during the year. (For uses of the Reserve Fund, see also Articles 77 and 78.) The budget covers a calendar year (Article 55). The budget must be adopted before the calendar year; if it is not, a temporary financing and spending plan for 3 months must be adopted (Article 58). The budget must be publicly published and accessible to all residents (Article 59).

A city may secure a loan only if the State Auditing Agency assesses that repayment of the loan will not jeopardize financing of other expenditures. The city may issue debt or securities subject to permission of the Ministry of Finance (Article 83).

A city may not borrow funds to finance "regular activities of bodies and users of its budgetary funds, except on short-term basis and only if revenue flow is not continuous" (Article 84). A city may borrow funds to finance building and renovation and capital equipment.

The Ministry of Finance supervises the use of revenues in cities (Article 88). The budget and all amendments must be forwarded to the Ministry of Finance within 15 days of their enactment (Article 94). The Ministry of Finance may ask the State Auditing Agency to investigate financial operations of a local government regarding “security, reliability, efficiency, efficacy and rationality of use of budgetary funds” of a local government (Article 88).

CURRENT SYSTEM FOR FINANCING CAPITAL PROJECTS

There is currently little financing of any local government capital projects in Croatia. Cities generally do not use long term loans or municipal bonds to finance facilities, infrastructure or capital equipment. The resources for both financing infrastructure and for maintenance and development of utility infrastructure comes from various sources: fees, transfers from the city budget, grants that come from the central government agencies, financing from companies building infrastructure and some short term loans.

The financing of capital projects is generally done through a combination of sources of funds. Loans for the public utility infrastructure is accomplished by the companies applying for loans for capital investments. The loans are repaid from transfers from the City budget. Public utility companies use this financing for major maintenance and small scale reconstruction of the existing infrastructure. Capital investments (larger scale of reconstruction of the existing infrastructure and new construction) have been financed through the city budget and through various fees. If capital infrastructure facility is of regional interest the Republic will finance construction of the facility through the national companies (Water Management Co., Croatian Roads Co.) and sometimes by getting foreign loans (World Bank and the European Bank for Reconstruction and Development).

For development of water and sewer system, users pay the following fees:

- a. Fee for waste water. The fee is set by the Government of Croatia.
- b. Fee for fresh water use. The fee is set by the Croatian Government for each cubic meter.
- c. Fee for water protection (paid by all users who deposit waste waters and other waste materials). The fee is set by the Government, and is paid to the Croatian Water Co. and Water Management Co.
- d. Fee for use of gravel, sand and stone from waters. This fee is set by the Croatian Government.
- e. Fee for irrigation.

Capital investment for development of transportation infrastructure of the cities is financed out of the city budget and from loans.

In housing and utility management, development of capital infrastructure is financed from budgets, from the rent of office space, from the resources collected from the sale of the socially owned housing stock, and from the resources of investors in public facilities.

Municipal Bonds and the Capital Market

Several of the city officials consulted said it was “illegal” for a city to borrow from banks to finance capital projects. As discussed in the legal framework section, it is legally possible for cities to finance projects. Articles 83-86 of the Law on Financing of Local Self-government regulate the practice of borrowing money. Article 83 establishes the right of cities to issue bonds (treasury notes) with approval of the Ministry of Finance. There is a new law on Securities and a Securities Commission has been established.

It is generally not done now and is not the tradition for financing such projects. Financing is short term and comes from individual banks or the national bank for reconstruction and development.

The Croatian Banking System

Most banks are not involved in financing infrastructure through long term loans or bonds, but there is a growing awareness in the banking sector of the possibilities for financing infrastructure through the use of municipal bonds.

The Croatian banking system includes a National Bank, the Croatian Credit Bank for Reconstruction and Development, the Ministry of Finance, an Association of Banks and Commercial Banks, and Savings, Mortgage and Housing Banks. Each of these is discussed below.

1. The **National Bank** deals with monetary policy, inflation and foreign currency exchange issues. This bank establishes rules for all business banks (non-governmental banks).

2. The **Croatian Credit Bank for Reconstruction and Development (HBOR)** was founded in 1992 with the independence of the country. The bank is governed by a Chairman and Board of Management appointed by the national government. The Credit Bank has had direct appropriations from the government every year and implements projects approved and funded by the Republic of Croatia. The bank has been funded from the government at about 300 million German marks for priority projects.

Foreign sources of capital for infrastructure go through this bank and provide its other source of capital. This bank supervises and audits loans to other banks for specific purposes; there is no

general transfer of funds. An example of a large, long term project financed with foreign capital is the six-city Municipal Environmental Project EBRD/World Bank project that began before the war. The project, which includes both Split and Rijeka, is for water and sewer projects, and is back on line after having been suspended for two years. The project is funded 70% by a World Bank loan and 30% from the national government and the cities. The feasibility studies and financial analysis were done under the auspices of the EBRD. Construction costs estimates are expected by August, 1996, with authorization for the EBRD procurement process to begin immediately thereafter. First authorizations for construction are expected by the end of 1996. Pula and Rijeka are for sewer projects only; the other cities will include both water and sewer projects.

During the first two years the Credit Bank funded projects related to water supply, sewer and airports. Since that time, all of the Croatian government-funded projects have been directed to rebuilding the war damage. The government has a "master plan" for the provision of water and sewer services, with priority given to water supply projects.

Cities can initiate project proposals to the Croatian Credit Bank by submitting feasibility studies, tender documents and bid responses. A bank representative indicated that credit packages were possible for water supply projects with a 6-year repayment schedule after a 1- to 2- year construction payment deferral and with annual interest rates between 7 and 9%.

3. The **Ministry of Finance** approves the amount to go to the Credit Bank from the national budget and regulates many financial transactions, particularly pertaining to local governments.

4. An **Association of Banks** whose membership includes all 57 banks in Croatia. (Banks are required to be members.) The association is supported by monthly dues from the banks and provides a forum for discussion of issues of mutual interest, research, a mechanism to comment on current or proposed regulations and other services to its members.

The Association has been in existence for four years and is one of thirty associations of the Croatian Chamber of Commerce. The Chamber of Commerce organizes the bi-monthly meetings of the Association, develops the agenda from topics suggested by the banks and prepares the minutes of the meetings to go back to the banks. It is this Association that recently reviewed a proposal for expanding the use of municipal bonds and sent it to the Ministry of Finance for consideration. When asked where to begin efforts to develop a municipal bond market, most of those interviewed suggested this Association.

5. **Individual Commercial Banks.** These banks deal primarily with corporate clients. There are contracts between banks that allow customers to cash checks at various banks. These are legally binding, but voluntary, agreements.

Local governments keep their deposits in the major bank in their community. Individual banks have little capital for infrastructure because of the deposits used or devalued during the war. These banks are the source for some short term loans to the city or city utility companies for infrastructure and capital equipment. These loans are typically gap financing, with high equity and city guarantees of repayment required.

6. Savings Banks, Mortgage Banks and Housing Savings (or “Communal”) Banks. These banks may be either public or private banks. If they are public, their founders and administrators may be local governments that then guarantee the obligations of the bank with local government funds. Savings banks, for example, encourage savings and may make loans to finance public projects. Mortgage institutions make loans based on real property mortgages and can also be used to finance local public projects. The housing savings banks collect savings deposits to invest in housing and communal projects (public utilities and other public projects).

Some cities have contemplated setting up “Communal Banks” with city funds to finance government operations and infrastructure. The Institute of Public Finance did a study for the City of Split to examine this question and said the establishment of a separate bank was not necessary.

In addition to accessing capital through domestic bank loans supported by the national government and foreign development bank loans, some local governments are working with local banks to issue municipal bonds.

County of Istria Bonds

The County of Istria is the first and only unit of local government to issue bonds. These bonds were issued in December, 1994. These bonds were issued to finance a portion of the development of a waste treatment plant in the City of Pazin.

The two million German marks’ worth of bonds were offered on the Croatian market through a network of Croatian banks and brokerage firms, led by the brokerage house of INVESTCO in Zagreb. Bonds of the County of Istria are annuity bonds with repeated, serial maturity. This means that during the amortization period, principal and interest are returned together through equal semi-annual annuity payments. The bonds will be repaid through 6 equal payments beginning June 30, 1995 and ending December 31, 1997. The repayment of all debts is guaranteed by Istarska Banka in the city of Pula.

According to the bond prospectus, Istria is a county of average size and population. Its economy is one of Croatia’s strongest. With 5.3% of the population, the county produces 6.5% of Croatia’s GDP.

The City of Varazdin is now preparing to issue municipal bonds and is working with a brokerage firm to develop the financing plan.

Brokerage Firms

There are several brokerage firms being formed that are encouraging banks, local governments and the national government to use municipal bonds as a way of financing infrastructure.

In June of 1996, the brokerage firms of CORA and FIMA presented the Association of Banks a study entitled "On Issuing Bonds of the Republic of Croatia for Economic Development". This study was discussed in a meeting of the Association, approved and sent to the Ministry of Finance for favorable consideration. The study discusses the advantages of bonds and ways to make them a more secure and thus more marketable investment. Representatives of CORA feel the same principles apply to municipal bonds as to national bonds. In fact, FIMA is working with Varazdin on their proposed bond issue.

Significantly, the study encourages bonds as a way to raise domestic capital and cautions against over-reliance on foreign capital:

"An engagement of foreign capital for the reconstruction and development is potentially an interesting source of finance, but the overall amount of this foreign capital is too small to play a significant role."

The study also cautions against thinking the Croatian banking system can supply all the needed resources needed:

"Banks, bearing the burden of the past, are not able to give their full contribution to economic development because they are having to go through their own process of rehabilitation."

The report recommends guidelines for the issuance of bonds, such that the central government support of this financing instrument at the national and local levels, initial sales be negotiated sales and that sales on the secondary market not be limited or restricted. The guidelines also recommend various guarantees for the investors including: bond denominations expressed in German marks, interest rates higher than those of banks, the use of bonds as a means of payment and the use of bonds as collateral.

ZAGREB

General Context

The City of Zagreb has a population of 882,000. During the period of 1991-1995, there were approximately 150,000 refugees and displaced persons added to the area of Zagreb. According to the City (report for the USAID project), there are 306,100 households, with an average annual household size of 2.88 and a family income of 27,350.00 Kn (\$5470.00).

The City of Zagreb is the capital of Croatia and is located in the central part of the country.

The City has a master plan and district development plans. Development must be consistent with these plans. Consistency is enforced through the building permitting process. Since the City has the legal status of a county, this permitting process is under its control. In addition to consistency with development plans, environmental impact assessment and utility availability are also checked. The average permit processing time was estimated at 6 months.

City Infrastructure

The City of Zagreb is implementing the new law on Utilities and Public Services with a market-oriented approach to the management of utilities. The reorganization of several utilities and public service enterprises is in progress. The utilities are establishing profit and expense centers, with each having its own budget and projected income. To increase operational effectiveness, similar utilities and public service organizations are being merged (for example: water supply, waste-water services and drainage have been combined). The City expects this reorganization to improve management and facilitate financial transactions and access to capital markets.

According to the information prepared for this assessment, the City expects to use a special expert group for the development of investment management in the utilities and public services infrastructure.

The *Basic Guidelines for the Development of the City of Zagreb* (1994) define the goals for the development of the utilities infrastructure and public services. Based on these guidelines, specific documents have been drafted to implement the basic goals. These documents include spatial plans, urban plans, and administrative directives. The City of Zagreb has officially confirmed its policies for quality utilities and public services in the "Directives for Quality Services".

The Public Utilities of the City include:

1. **Gas.** There are 700 employees, 120,000 customers, 1114 kilometers in the distribution network, and an average annual per capita consumption of 320 million cubic

meters of gas. The primary need of the gas company was identified as extension of service to unserved areas.

2. **Solid Waste and Street Sweeping.** There are 1,450 employees serving 235,000 apartments, collecting 3,000 cubic meters of waste per day. The City has an extensive recycling program. Types of material recycled include: grass and tree trimmings, medical waste, organic waste, glass, paper, plastics, batteries, and aluminum. Hazardous waste is not included in this service. Fees for apartments are assessed by the square meter of the apartment.

3. **Environmental Protection and Waste Management Company.** There are 15 employees providing ecological analysis and environmental educational services. The City has an extensive recycling program. Types of material recycled include: grass and tree trimmings, medical waste, organic waste, glass, paper, plastics, batteries, and aluminum. In 1992, this organization was designated by the Ministry of Construction Industry and Environmental Protection as a national organization promoting environmental protection.

4. **Water and Wastewater.** There are 1,300 employees, 720 in water services, 300 in wastewater services, and 300 in administrative services.

The water company is 118 years old and serves Zagreb and the surrounding area. There are 10,400 kilometers of water pipes, with 80,000 customer connections. Approximately 10% of the city is not served by water. The average per capita consumption is 120-123 cubic meters of water. Water services are primarily pumping and distribution. Water supply is from the aquifer under the City and is accessed by wells. Pollution is identified as a major problem.

The wastewater system is a mixed system, combining residential and industrial waste and storm water runoff in the same collection system. There are 1,100 kilometers of sewer pipes in the collection system. Approximately 30% of the city is unserved. There is an industrial pre-treatment program. Approximately 50% of the industries pre-treat their waste. There is no treatment plant. Officials of the wastewater system said it would take billions of dollars to bring the sewer system up to European standards.

Organization and Structure

Zagreb is the only unified city in Croatia; it is both a city and a county government. The boundaries of the city are smaller than the boundaries of the county (see map, Figure 3), but the city has the powers of a county and the governing structures of the city and the county are integrated.

The City Assembly has 50 members, all of whom are also members of the 80-member county Assembly. The Assembly has proportional representation, with approximately eight parties represented.

The Mayor is also the County Executive. This combined chief executive has recently presented a problem for Zagreb because the President of the country has the authority to approve any County Chief. The elected Mayor of Zagreb was not approved by the President because he was of a different political party. The Assembly elected another Mayor, who was turned down by the President for the same reason. Now the President is to nominate a Mayor, for approval by the Assembly. The expectation is that the Assembly will reject the President's nominee. While all of this political dispute goes on, the city is effectively without a chief executive.

The organization of the City of Zagreb is depicted on the organization chart (Figure 4). The City Assembly is made up of 50 members, elected by district for four-year terms. The Assembly is chaired by a President; the Mayor is not a member of the Assembly.

The Mayor is directly elected to four- year term and is the head of the Executive Council. The Executive Council is composed of 15 members appointed by the Assembly. The Mayor has direct line responsibility for 13 city departments, plus general administration and the Fund for Water, Transportation, Housing and Communal Systems.

Both the Assembly and the Executive Council have departments reporting directly to them; 6 departments report to the Assembly and 7 to the Executive Council. The Assembly also has Permanent Bodies of the Assembly reporting to them. The Executive Council has Working Bodies reporting to it, as well as the Public Utilities and Enterprises. These Public Utilities and Enterprises are viewed as independent, even though the Mayor appoints the directors and the budgets for these activities are part of the total city budget.

There are also 13 field offices in the city organization.

Budget and Finance

The city of Zagreb does not have a budget plan for the fiscal year 1996; instead the City Assembly has authorized three-month temporary financing for the period of January-March 1996. Under Croatian law, the budget for the remaining part of the year has to be approved by March 15, 1996. Revenues and expenditures are illustrated in Figure 5 and Figure 6.

Temporary financing of the City of Zagreb comprises:

Revenue:	382,500,000 Kn
Expenditures	359,485.100 Kn
Reserves of the City	23,041.900 Kn
Total expenditures	382,500,000 Kn

Revenues of the City of Zagreb include:

1) Tax revenues

A) profit and income tax share in the budget is 342 million Kuna or 89% (share in tax and income surtax is 300 million Kuna, and share in profit tax is 41 million Kuna);

B) real estate and transfer of rights tax share in the budget is 27.1 million Kuna or 7% (inheritance and gift tax is 2 million Kuna, relisted tax is 25 million Kuna, and summer and gift tax is 2 million Kuna);

C) share of domestic turnover tax on goods and services in the budget is 6.76 million Kn or 1.77% (tax on firm or company name is 1 million Kuna, tax on advertising is 0.5 million Kuna, tax on motor vehicle is 1 million Kuna, tax for organizing gambling games is 0.01 K, tax on organizing amusement and sports events is 0.25 million K, consumption tax is 4.0 million K).

2) Other revenues

A) Administrative fees: 2.8 million Kn (Administrative fees are 2 million, government fees are 0.8 million Kn);

B) Revenues based on special regulations (fines) are 0.4 million Kn;

C) Miscellaneous revenues are 4.44 million Kn.

The budget of the City of Zagreb does not include the financial plan of the Fund of the City of Zagreb for water management, transportation, housing and public utility service. The Fund developed a temporary financial plan for the same period of time January to March 1996 as did the City. The temporary plan is based on the analysis and estimation of the inflow of resources in the last quarter of 1995 and the fees obtained from that period. Total revenues and expenditures of the Fund are estimated to be 278.3 million Kuna.

The revenue plan of the Fund consists of the following revenues:

A.	Water management - 13.4%	40 million Kn
	1. Water management fee	14.0
	2. Water use fee	12.6
	3. Water protection fee	8.4
	4. Water management contribution	5.0
B.	Transportation - 3.5%	9.8 million Kn
	1. Assets of the Croatian Roads Co.	5.3
	2. Annual fees for the use of roads	4.5

C.	Housing and Public Utility Serv.- 53.3%	148.5 million Kn
1.	Rent and condominium fee	14.0
2.	Rental fee	52.0
3.	Public utility fee	50.0
4.	Funds from sales of socially-owned apartments	2.0
5.	Funds of the investor of another structure and equipment for individual utility consumption	12.0
6.	Funds of the investor of another structure and equipment for public utility consumption	18.0
D.	Other Revenues - 29.8%	80.0 million Kn
1.	Budget of the city of Zagreb	70.0
2.	from different sources (from citizens, donation, sponsorships, office sails, etc.)	7.5
3.	Obtained from interest rate on sight assets and interest on court decisions	2.5

In 1995 the total revenues of the public utility companies were 2.395 million Kn. In 1996 the revenues of the Fund in the amount of 278.3 million Kn are allocated according to the services: 20.6 % to the funds to finance water management to the funds to finance transportation, 61% to the funds to finance housing and public utility services, and 3.1% to funds to cover the operation of the Fund of the City of Zagreb for Water Management, Transportation, Housing and Public Utility services.

Allocation of the funds for water management is as follows:

50% water
20% sewer
30% environmental protection

The urban infrastructure in the City of Zagreb is financed primarily through funds from the city budget. Fees charged for the services are set to cover the majority of operation and maintenance costs, but not the capital costs.

There was no calculation for the percent cost recovery of fees charged for the various public services. There is no cost accounting system that would facilitate calculation of cost recovery for operations and maintenance expenses, and no current definition of cost recovery that would include capital expenses.

Funds available to finance infrastructure are insufficient for the needs determined by the City. There is little long term credit and little money available from the central government for financing infrastructure.

According to information prepared by the City for this assessment, the 1994 structure of financial resources for utilities and public services (water supply protection, waste water, water conservation, maintenance and reconstruction of streets and roads, subsidies for Croatian Railways, construction of utilities on land to be developed) was:

25.1 %	payments and contributions (water management payments, compensation for the use and preservation of water, public service compensations, compensations for the uses of roads and water management contributions)
44.2 %	Zagreb city budget
17.4 %	Funds of investors in other facilities for the construction of utilities installations for individual and common use
6.4%	Loans from <i>Zagrebacka banka</i> (Zagreb Bank)
3.1%	Funds from <i>Hrvatske ceste</i> (Public Roads Company)
3.8%	Other (profits, interest, etc.)

The city finances public utilities partially through a special fund. Figure 7 illustrates the redistribution of revenues among the utilities in the fund.

Priority Concerns

The concern that motivates Zagreb's interest in working with USAID is housing and municipal management improvements. Housing is seen as critical to retaining young professionals in the city. Municipal management improvements focused on the following areas:

1. **Improvement of city administration and management.** The organization and management of the large city organization were described as cumbersome and complicated. There is a sense that the organization is not as efficient as it needs to be. Specific concerns mentioned were the decision-making process, the budgeting process, performance measurement and monitoring.

2. **Improvement of the political decision-making process.** The relationship between the City Assembly, the Mayor and the Executive Council was described as cumbersome. The structure of the relationships was identified as at least part of the problem.

3. **More effective land use policy.** There are city and regional land use plans. The city is interested in a more effective involvement of private developers in the implementation of the plan and in paying for the costs associated with development.

4. **Legislative reform.** There is legislation to be considered in the Parliament that would reform the duties and powers of cities with a population of over 40,000. Although Zagreb has most of the powers being contemplated for these cities (because it has dual status as a county), there is a need for other large cities to have more authority.

5. **Information system improvement.** There is a need to modernize the information systems that support the city operations.

6. **Intergovernmental relations.** There is a need to clarify roles of local self-government units and to give more fiscal authority to the local level.

7. **Privatization of city services.** What are more effective ways to grant concessions for operating city services? How can levels of service and performance standards be assured?

8. **Capacity building of the city workforce.** Many city employees need to update or acquire new skills. There is currently no effective training to improve the capacity of the workforce.

9. **Protection of water supply.** Pollution from sewer, the landfill, the railway station, the airport, and highways are a specific concern. There are not sufficient funds for infrastructure improvements to protect the water supply.

10. **Sewer** concerns focus first on industries not following industrial pre-treatment regulations and second on improving the sewer collection and treatment system. Funding is not available for infrastructure improvements needed for the wastewater collection and treatment systems.

OSIJEK

General Context

The City of Osijek has a current population of 100,000. There has been significant change in the population during the last 4-5 years because of the war. There are an estimated 35,000 refugees and displaced persons (mostly from the eastern sections nearest the city).

Osijek is located in the eastern part of Croatia and sustained substantial war damage. There were 1,000 civilians killed and 5,000 wounded. There was shelling as recently as August, 1995. The city is surrounded on three sides by occupied territory. Although the city has been rebuilding and repairing housing and other structures for the past four years, there is still substantial reconstruction necessary.

By territorial reorganization, Osijek became a smaller jurisdiction when it was made a city. Osijek used to make up what is now the central city and five suburban communities.

The economy of Osijek is estimated to be half of what it was before the war. There are currently (as of March, 1994) 3,296 firms in Osijek, 1951 of them are trade or retail firms, 374 are financial and technical services, and 238 of them are industry. The city's economy had been substantially oriented to industry before the war. The small number of industrial firms now is a major concern for the city. The city is also concerned that there are no legal instruments to encourage industry.

The city has established an economic development function to address the concern of rebuilding the economy. Recently the city established a small business incubator to encourage new businesses. The city deposits into banks are being used to guarantee loans needed by the small businesses in the incubator. Another economic development program of the city has been developed in conjunction with the German Chamber of Commerce. This program will provide training to managers of businesses, many of whom are war veterans with little previous experience in the jobs they are now holding.

The city has a master plan developed in 1988 which now needs to be completely revised based on the experiences of the war. Demographic and other projections are difficult because of the interruptions and difficulties of the war. National law requires the city to develop a new plan by 1999. The plan will include public infrastructure development. The county is also developing a plan on the same schedule. The city plan must be consistent with the county plan. There is little cooperation currently between the city and the county in developing these plans.

Organization and Structure

The major portion of city services are delivered by five public companies: water production and distribution, transportation (trams and buses), waste disposal, city cemeteries and public markets.

The city owns 7 public enterprises and has 8 departments. To illustrate the relative size of the operations, there are a total of 520 employees in the water company compared to 130 employees in the city.

The Water Company generates 72% of its revenues from commercial activities and is self-supporting in its water and sewer operational costs. The City contributes capital funds on a project basis. In one multi-year construction project at the water treatment plant, the financing includes a combination of World Bank funding (\$8.9 million), Water Company (\$1 million), the City (\$2.6 million) and the Croatian Bank for Reconstruction and Development (\$1.6 million).

The transportation company had deferred all procurement and major maintenance during the war. The City is responsible for all capital purchases and in addition subsidizes the operational costs. The Transportation Company does not use cost benefit analysis nor match fares with the cost of service.

The waste disposal system receives 40% of its revenues from the City budget. The company receives a communal fee, but the collection rate is only about 50% on average, with industry paying at a rate of 80% and residences only at 20%. Collection is not automated, nor are there many collection tools. The fee is a 5 zone/3 use fee structure.

Services of the company include garbage and trash collection, waste disposal, maintenance of all green areas on the city property and street cleaning. The major issue in waste disposal is the location of a landfill.

City Cemeteries are 90% self supporting for operational costs. The City Markets are self supporting for operational costs. The market has free dumping at the landfill and thus receives an indirect operational subsidy. In addition, the City is paying for the capital construction costs of two new projects.

The structure of the city organization is illustrated in Figure 8.

Budget and Finance

The total budget is 160,064,120 Kn, with a reserve of 1,000,000 Kn.

The revenues and expenditures in the Osijek budget are detailed in Figures 9 and 10.

The sources of revenues, expressed in Kuna, are:

Taxes	67,340,470
Capital Income (income from city property sold)	38,080,000
Fees	54,493,650
Donations	150,000
Total	----- 160,064,120

The expenditures, expressed in Kuna, are:

Operational expenditures for employees	9,935,370
for current maintenance	10,642,000
for material, energy and utility and other services	13,616,000
Current external expenditures for materials and services for environmental protection	1,110,000
for public order security	1,676,000
other unspecified expenditures	12,539,000
Current transfers Current transfers to citizens households and non-fiscal organizations	36,818,750
Current transfers to government institutions	1,213,000
Subsidies Subsidies in agriculture	200,000
Other current transfers and donations	3,617,000
Capital acquisition Land and other tangible assets	2,000,000
Building structure	5,000,000

Office furniture and equipment	5,000,000
Other tangible assets	80,000
Intangible assets	5,950,000
Supplies	50,000
Construction capital structure	33,921,500
Investment maintenance	1,500,000
Capital transfers to citizens, households, and non-fiscal organization	14,205,500
other capital transfers	1,300,000
Given government loans and share in capital amount	
Domestic loans	3,000,000

In 1997 a rise of total revenues in the budget is planned for 6.7% and in 1998 for another 8.4%. The capital investments in infrastructure in Osijek have been supported by the national government as a part of a reconstruction program in the country.

There has been water treatment plant reconstruction and expansion recently financed from the following sources:

Croatian Bank for Reconstruction

National Water Enterprise

City of Osijek

World Bank

The central government has promised the city of Osijek bonds in the amount of 20 million German Marks as compensation for the housing sold within the city limits. The city has not been able to use this source of funds because the central government does not have the money to finance the bonds.

The central government has given the City of Osijek some money from the sale of housing to reconstruct some housing (2 buildings) for war victims.

Priority Concerns

The Deputy Mayor and other officials identified infrastructure improvement as the top priority for the city. The city's economic recovery strategy is to provide infrastructure and housing to

encourage economic investment. Economic recovery is essential to address the major concern of young professionals leaving the city. Specific infrastructure needs are:

1. **Waste water system.** The primary goal is the sewage collection system. It is a major concern because it is necessary for the economic development of the city. There is currently a large amount of agricultural land within the city limits that needs to be relocated because of pollution from waste water.

Also needed is the construction of a sewage treatment plant. The site that had been selected for the sewer treatment plant is in the occupied territory, so the site is now in doubt. There is no financing to build the plant.

2. **Garbage disposal.** The landfill for the City of Osijek is located in an area that is now occupied. Since the city has not been able to use its landfill during the war, it has established multiple dumps in other areas of the city. These other sites are near residential development and have very little capacity. The implementation of agreements on integration of currently occupied areas will take time, so the city is concerned about solid waste disposal at least until the former landfill is available again.

SPLIT

General Context

The City of Split has a population of 170,000. The City is located on the coast of Croatia. The city is 1700 years old.

The city has a limited number of apartments in the central city and little land to develop. There is concern among city officials to preserve the historic structures of the city and still provide adequate housing.

Organization and Structure

There are 26 members in the City Assembly and 12 members in the Executive Council, including the Mayor. There are 8 departments, not including the public enterprises. The structure of the city organization is shown in Figure 11).

Budget and Finance

The city charges a communal fee for street lighting, parks and public areas maintenance, street sweeping. The fees are set as amount per square meter of different land uses, in different areas of the city. The communal fee schedule, in Kuna, is:

TYPE OF USE	CENTER OF CITY	MID CITY	OUTER CITY
Business	4.20 Kn	2.90	2.40
Housing	0.54	0.36	0.14
Industrial	0.70	0.30	0.29

The total annual revenue from the communal fee is 80 million Kn. There is a 50% collection rate. The city can sue for non-payment of fees, but the court process is slow. It takes up to 2-3 years to resolve suits for non-payment in the courts. Approximately 25% of the past due bills are finally paid.

There are separate fees for water and solid waste collection.

The fees are not adequate for the maintenance and operations infrastructure needs. The fees cover no capital investment costs.

One year ago the City Assembly considered infrastructure needs and decided to dedicate revenues from the sale of housing to infrastructure finance. The total invested in 1995 was 43.8 million Kn and for 1996 was 30 million Kn. The types of projects financed are described in Figures 12 and 13, supplied by the city of Split. Approximately 80% of the apartments are now sold so this source of revenue will not last into the future.

Other sources of financing for infrastructure are the sale of office buildings and the sale of city land for development.

The city has recently financed a waste water plant with a surcharge on the water fee to repay financing offered by the company constructing the plant. The city increased the monthly fee of 3.60 Kn per cubic meter by 35 lipas for sewer investment and 15 lipas for water investment. In 1995, the City borrowed 8.3 million Kn from the construction company for a five year term. The plant was partially financed by the World Bank and the EBRD.

Priority Concerns

1. **Sewer.** Waste water services are a priority concern for the eastern part of the city. The City is in the process of building a sewage collection system and treatment plant. Sewer improvements are financed 50% from water fees and 50% from a grant from the Ministry of Reconstruction.

2. **Housing.** Housing for low income people; maintenance of existing housing; informal housing (built without the necessary permits).

RIJEKA

General Context

Rijeka is a coastal city of 180,000 population, in a metropolitan area of 270,000 population. The metropolitan area consists of Rijeka and seven suburbs. The City has had the official status of a city since 1990. Before becoming a city, Rijeka was part of a territorial unit of a commune that was 10 times larger in area and 1.5 times larger in population. The City feels its current boundaries are too small to accommodate growth of a metropolitan area, or to reflect the actual operation of the metropolitan area. The service area of Rijeka's public utilities reaches these suburban areas. Rijeka's land area is only 50 square kilometers.

As of March, 1996, the County of Rijeka had no County Assembly for the past three months. The County Executive and County Executive Council were relieved from office by the County Assembly. Under the Law on Local Self-government, a new Executive and Executive Council must be appointed within 15 days, or the terminated Executive can dissolve the Assembly. There are also problems re-electing the County Assembly because the current laws do not address this contingency. Since the County is in a state of transition, there is little exchange between the county and the city on planning or other areas of common interest. Even without this current difficulty with the County leadership, there has been little time to integrate the new structure of the county and to sort out the roles of the city and the county in local self governance.

The County has begun a general plan for the county in accordance with the Law on Physical Planning that requires a new plan by 1999. The City feels the County should be coordinating more closely with the City because of the importance of the city's infrastructure. One difficulty for all the plans is the lack of reliable data and projections on which to base new plans.

The County issues building permits. Current plans that govern the issuance of permits are old plans full of restrictions on development. Clear title is the most difficult problem. It takes 1-2 years to get a building permit.

There is little problem with construction without permits. Most remodeling takes place without a permit, but only about 10-15% of houses are constructed illegally. Generally, these houses have been made to be legal.

The city has started several studies to develop data and modern land use approaches to planning. The city has approximately 20-30% of its land area undeveloped, most of which is in the western sector. The studies are dealing with the central area, neighborhoods, reconstruction and development of new areas. Rijeka describes its approach to planning as "sustainable" development.

The City is developing a Geographic Information System (GIS) with the University of Vienna serving as the technical consultant and Intergraph is the hardware supplier. The City has completed the pilot study for the system. Types of information expected to be included in the GIS are: seismological, watershed, utilities, land use, soil condition. The City expects to have the first operable part of the GIS in two years. The City of Pula is also starting a GIS.

The city is concerned about environmental protection, particularly the protection of water quality in the seven springs that supply the city's water supply. The springs are fed from a karst aquifer. There are County-wide regulations (proposed by the City) governing development in the recharge zone for the aquifer. There are 25 years of water quality monitoring data that supports this environmental protection initiative.

Another environmental protection initiative deals with Rijeka Bay. Rijeka is working with the Croatian Institute of Engineering and a Dutch firm. There has been some information exchange with Chesapeake Bay in Maryland.

There are approximately 43,000 total apartments in the city; 33,027 are now privately owned. The city owns 4,593 housing units now, but expects to sell more than half of those units by June of 1996, the deadline for purchase of apartments under the national housing law. The city expects to retain ownership of approximately 2,000 apartments to be used for low income housing.

Rijeka governs all property owned by the city, including the following:

1. The five enterprises that make up the public utilities. The city owns 100% of two of these enterprises; the others are approximately 80% owned by the city. The remaining 20% is owned by suburbs who have a voice in their management.

- A. City Transportation (trams)
- B. Water Supply and Waste water treatment
- C. Gas and Thermal heating (Energo) (100% owned by the City)
- D. Solid Waste Collection (Cistoca)
- E. Funeral and Cemeteries (100% owned by city)

2. Business areas (Commercial Property)

3. Housing Units (3,500 to 4,000)

4. Land available for construction (The city owns half of the property available for development)
5. Cultural institutions and sports facilities
6. One institution serving the handicapped
7. City open markets
8. Parks

One of the difficulties the City has in managing the property is that there is no real estate market in Croatia, so the City is determining the price for the sale of land for development. The city sets a minimum price for the land to be sold at auction. The City has a pricing structure that is determined by four land uses and five geographic zones of the city. For development, the City provides the infrastructure (financed from the communal fee) and the investor only pays connection fees.

Public Utilities and Infrastructure

The City of Rijeka operates five public utilities as non-profit firms. There are a total of 1,900 employees in all the utilities, 840 of whom are in the public transportation system. The organizational structure of the utilities is shown in Figure 14. Public utilities are financed through fees for services to cover operation and maintenance expenses. For all the utilities except transportation, 15-20% of the fee revenue is invested in capital expenses. The estimated operational subsidy for the transportation system is 25%.

The fees for public utilities are collected jointly on a monthly bill to residents. The collection rate has increased from 65% in January to 85% in February, 1996. Collection procedures are:

- a. After 60 days of non-payment F first past due notice is sent
- b. After 90 days of non-payment F cut off utilities; file suit for back payment, plus interest at current bank interest rate.

Only 3% of the past due bills need to be resolved by legal action.

The mayor indicated that those individuals and households with very low income (900 Kn per month) do not have to pay utility bills. The utility subsidizes these people and they are not included in the collection rate.

Water and Wastewater Utility

The water utilities company was established in 1885. The water distribution system in Rijeka is complete, with 99.9% of the citizens receiving service. The utility estimate that it has a 30-50 year capacity for water, so developing water supply sources is not a primary concern of the utility. The major concern of the water system is protection of the quality of water, particularly in the largely undeveloped watershed near the city. The city has been working on the issue of

protection of water quality for the past 25 years and is pleased with the results of their efforts. The city gets its water from seven springs at sea level in the city. The water distribution system must therefore pump water 480 meters uphill to supply the city.

Modern equipment is available to test for water system leaks. None of the water system maps or water quality data is yet computerized; it will be as part of the development of the Geographic Information System.

There are 650 kilometers of water pipes; only 200 kilometers of sewer pipes. Only 65% of the city (55,000 inhabitants) is served by waste water. The city has recently completed a waste water treatment plant, the first in Croatia. The treatment plant was financed in part with a loan from the World Bank. The plant provides primary treatment only, the mechanical removal of solids from the waste water. The capacity of the plant is 130,000 cubic meters per day. The city monitors water quality in the ocean where it discharges the waste water, but does not consider pollution sufficient enough to warrant secondary treatment (chemical and biological treatment) of the waste water. Treatment standards are similar to those of Western Europe.

The major problem for the sewer system is identified as serving the unserved area, mostly in the western and industrial area of the city. The other area that is a concern for connection are unserved areas outside the city limits that impact the water quality of the water supply springs.

The sewer system is a combined system, including industrial and household waste as well as storm water. In the suburbs and newer developments outside of the city, the system is separated. The city does have an industrial pre-treatment program.

Gas Company

The gas company was established in 1852. The City Assembly formed the company Energo to provide gas, hot water and central heating. The company serves 18,000 households, which represents approximately 30% coverage.

There is no natural gas on the entire coast of Croatia. (An Italian firm, AGIP, and Ina are exploring extracting natural gas from the sea; no natural gas is expected for at least 5 years.) To solve the transition period until natural gas is available, the company is using the same approach as Germany and Austria: mixed gas. The company has completed the construction of a pipeline for mixed gas with a 2 year financing from a German bank. The company constructed the first mixing station in 1991. The environmental protection benefits from using mixed gas are substantial because it replaces crude oil as an energy source. The company estimates it has avoided the use of 6.8 million tons of crude oil. One of the major users of mixed gas is the company Ina; it uses four times as much gas as the rest of the customers. Currently, gas in Rijeka is 27% more expensive than in the rest of Croatia.

Expansion plans for the use of mixed gas are to supply an additional 20 firms and 600 households and to connect the 17 thermal heating plants.

Solid Waste Collection

The solid waste collection utility is currently developing a new landfill site. Five potential sites were identified and one was chosen. The financing for the development of the landfill is not yet determined. Revenue sources include the solid waste fee, the communal fee (for public services and utilities) and the City budget. The utility could finance the landfill by borrowing from another utility for a term of 15-20 years. The guarantee for the repayment would be the public utility fees and the City of Rijeka.

Budget and Finance

The City of Rijeka finances its operations through three types of income: taxes, fees and profits from public enterprises. It is the first city in Croatia to use profit as an income source.

The estimated amount of annual investment in infrastructure is 50 million German Marks.

The City of Rijeka did receive some money from some of the sale of housing, but has used all funds to provide housing. None of the money was used to finance infrastructure or other services. Approximately half of the housing stock was sold for cash or foreign currency for which the city has been promised bond financing in the future. The apartments purchased with credits from savings lost in the banks during the war, the city received 35% of the purchase price. The city has used these funds to purchase 200 apartments. These apartments are rented to those on the waiting list for housing. There are 3,300 people on the list, all with some difficulty in obtaining housing. The mayor has about 10 units that can be used for professionals or other special cases.

The total budget of the city of Rijeka for 1996 contains the following:

Revenues	539,105,000 Kn
Expenditure	539,105,000 Kn

The sources of the revenues are:

Taxes	113,732,000 Kn
Capital Income	44,470,000 Kn
Entrepreneurial Activities and Property	151,027,600 Kn
Revenues according to special regulations	152,591,000 Kn

The expenditure for 1996 are as follows:

Operational expenditures	138,329,200 Kn
Current external expenditures	17,132,000 Kn
Current transfers	84,097,000 Kn
Subsidies	1,324,000 Kn
Capital Expenditure	271,867,800 Kn

Out of total capital expenditures 48.5% is spent for communal system, and 12% for housing.

Priority Concerns

The infrastructure and public service priorities were identified as:

1. **Wastewater treatment.** The primary concern is extending service to the unserved western area of the city.
2. **Solid waste disposal.** The primary concern is the financing and development of the new landfill site.
3. **Gas pipeline construction.** The pipeline will provide environmentally improved energy source to the major industries and many of the residents in the city.

RECOMMENDATIONS

General Strategy

The general strategy recommended for strengthening local governments in Croatia is designed to achieve the following strategic objectives:

1. **Strengthen local government to be accountable, responsive and effective.** Supporting democratic processes in the larger cities of Croatia will contribute to creating centers of democratic power beyond the central government. Specific improvements include better municipal services, economic development, better management of resources and greater accountability through effective and participatory decision-making processes. Longer term sustainability is sought through:

- a. the establishment of institutional and legal frameworks
- b. the development of Croatian capacity in technical support services
- c. strengthening communication and collaboration among cities
- d. the creation of viable models and examples of improved management and service delivery.

2. **Integration and development of Sector East.** The program should seek to leverage local and foreign resources to begin the reconstruction process, while helping establish management and decision-making processes that can deliver desired services for citizens. The program can help negotiate a common agenda between the exiled and current governments by focusing on concrete and tangible improvements. Integration can be fostered by the re-introduction of Croatian legal and political systems, and strengthening communication among cities.

The general strategy recommended is as follows:

1. Focus on Zagreb, Split, Osijek and Rijeka, the four largest cities in Croatia. Because of their size and importance, they will have substantial impact on the Croatian development and have greater capacity to impact national policy and institutions. In addition, the cities of Varazdin and Vulcovar can be included to further the strategic objectives.
2. Foster information sharing among cities in Croatia to build an advocacy voice for local governments and maximize the use of regional experience and internal experimentation and innovation.
3. Establish partnerships and collaborative relationships with each city to ensure full commitment in design and implementation.

4. Build sustainability while being cost effective by using local consultants and institutions.
5. Focus on priority issues of high interest to the cities to provide tangible results that can lead to longer term rewards from a partnership.
6. Leverage local and foreign technical and capital resources to accomplish project goals. Use experience and materials already developed in Croatia and throughout Eastern and Western Europe and other places, as appropriate. Access capital from local and foreign sources, including World Bank, European Union and other funding sources active in Croatia.
7. For Sector East, the strategy should focus on building interaction by sharing information, delivering tangible results while working on longer term issues, and assisting in re-introducing political and institutional systems common to Croatia.

Factors That Will Facilitate a Successful Project

There are several factors that will facilitate a successful project with the cities. Each of these factors is discussed below. The most important aspect of this assistance is that it is undertaken in partnership with each city. These specific factors are ways to effectively implement this partnership.

1. The assistance will be a project that is important to the City.

Each of the cities has expressed their priorities for their city and are actively pursuing them. The project should address these priorities. The assistance can be to an on-going project or issue or one that will be initiated by the city. The assistance is to help the city get done what it needs to get done. An advantage to a project selected for assistance that is generally perceived to be important is that progress in this area is both significant and helpful.

The ideal project is one that will produce models and ideas for other cities that may be grappling with similar issues. Successful approaches can then be shared, reinforced and tried in other locations. Conferences, workshops and other ways of communicating among cities can be fostered if the subject matter is of interest to most.

2. The assistance team will work with the designated project leader and project team from each city in the design and implementation of the assistance project.

The project leader in each city is a key player in successful implementation. The leader's interest in the project and commitment to its objectives and authority to make decisions about the project, to gather resources to the project, to communicate the project's objectives and progress, and to assist in conflict resolution will make the project successful. The project leader

is also an important communication link between cities in sharing the good ideas and experiences from the project with other cities.

The project leader will be assisted by a project team from the city. The team will include those with the technical skills and interest in the project.

3. Discussions will be held with each city to determine the content and the form of the assistance project.

Discussions will take place with each city to plan the assistance project, specifically the purpose, the time frame, the type of technical assistance (for example: analysis, consultation , workshops and conferences, training) and the amount and schedule for the assistance.

The discussions with each city will also include expectations and responsibilities of the City in the assistance project. Topics for discussion might include such things as: the responsibilities of the project leader and the project team, provisions for discussing and agreeing to any changes necessary during the assistance project, any resources (time, money, personnel) that are needed for the project, the primary client for the project (probably be the Executive Council), and any other expectations or concerns the city has for the project.

The city's preferred way of communicating about the project to the local media and citizens and to other cities or interested parties will also be discussed.

The form of the agreement with the City will be discussed with each City. In general, discussions about the technical assistance agreement should be followed by a written agreement with the City.

Recommended Areas of Concentration

The focus of projects with the cities should be on creating an enabling environment at the local level -- for increased decentralization, for collaboration among cities, for economic development, for improved quality of life.

The areas of concentration should reflect the top priorities of the cities. Preliminary indications are that these priorities are:

- 1) financing infrastructure improvements
- 2) improvements in management and budgeting
- 3) economic development
- 4) developing a revised master plan for metropolitan development

5) developing an effective voice for local government in national policy and an effective mechanism to share ideas among cities.

Each of these priorities is discussed below, with suggestions on the type of assistance and projects that might be useful to the cities.

1) *financing infrastructure improvements*

All of the cities were concerned with building or rebuilding infrastructure as critical to recovering from war damage. Infrastructure was seen as key to providing an environment favorable to economic development and improved quality of life for residents. The type of projects most often mentioned were water and wastewater improvements, particularly wastewater improvements.

One promising area of assistance is financial analysis and management improvements to make wastewater system improvements financable. Since these services are provided by public enterprises with fee structures already in place, financial analysis would include such things as: determination of the full cost to provide the service (operations, maintenance and capital costs), the percent cost recovery from fees, a market analysis of competitive rates, The market tolerance for increased fees and fees for extension of service to any unserved areas, development of alternative rate schedules to achieve full cost recovery over time, analysis of collection procedures and collection percentages, analysis of alternative sources of financing, and development of enterprise budgeting that reflects the total operation of the enterprise. This analysis would help assess the marketability of any bonds to finance infrastructure for the utility.

Since there is potentially funding for infrastructure improvements available from international sources, as well as the beginnings of a private capital market in Croatia, assistance could also be provided in preparing financial analysis, procedures and documents necessary to apply for loans or issue bonds.

The management improvements would be such things as the implementation of revised procedures and management approaches for: cost accounting, rate analysis, budgeting, collection procedures, customer orientation, and citizen information and involvement in the changes that affect them. Customer orientation in billing systems, delivery of service, resolving complaints, determining fees and collection procedures all are potential areas for assistance.

Another area for assistance is improving the management structure of city operations, including enterprise operations. Several also felt decision making processes in the city--both political and administrative--could be improved with knowledge of how other cities functioned. Types of assistance could include organizational diagnosis, organizational structure, management

techniques and approaches, employee involvement strategies, process improvements, system re-design, and service quality improvement strategies.

An additional area for management assistance is the relationship between the central city and surrounding cities in developing, financing and operating regional water and wastewater facilities. Types of assistance might include workshops on sustainable urban development, regional cooperation, analysis of key issues of regional concern and identification of policy options, and assistance in developing informal mechanisms for communication among jurisdictions.

2) improvements in management and budgeting

There is also considerable interest from the cities in general improvements budgeting and in the management and operations of the city. There is concern specifically that the budget is not clearly organized and is difficult for elected officials, operations managers, citizens and other users to see total expenditures for types of activities. Budgets are not consolidated and thus do not reflect all public expenditures in one document. Since public utilities are operated by semi-autonomous agencies, it is difficult to assess the total city commitments and flow of funds. Several cities indicated an interest in revising the form of their budgets to fully reflect all the expenditures that the city controls, including public utility companies.

There is currently no performance information in the budgets and many are interested in a budget that is more like a program budget than the current line item budget.

Cities do not currently have a capital budget to assist in the planning for and financing of public infrastructure.

Management and information systems to support budget changes will be necessary to fully implement improvements.

The types of assistance that might be useful to address these concerns are: use of fund accounting, development of alternative budget formats that are closer to program budgeting, revised accounting and reporting systems to track budget performance, the development of a capital budget, revision of budget development and review process to make them clearer and more inclusive, and assistance in restructuring the budgets and the reporting systems that monitor the budget.

These opportunities also contain the possibility of involving citizens in new ways in local government. Opportunities are great to foster a customer orientation in services and to increase the amount and effectiveness of citizen participation in planning and decision making.

3) economic development

Cities also expressed interest in economic development. Specific types of assistance that might address this area are such things as: information of the different roles of municipalities in economic development, development and analysis of information on current and potential businesses and industries, identification of opportunities for public-private partnerships, development of marketing information and strategies, identification of opportunities for regional and national cooperation in economic development, establishment or improvements in municipal economic development offices.

4) developing a revised master plan for metropolitan development

Another opportunity for assistance is the requirement of both cities and counties to update their master plans by 1996. Using the planning process as a means of thinking and acting strategically to create economic and social opportunities would be a way to integrate many of the concerns expressed by cities for management improvements, infrastructure planning, economic development and better relations with surrounding cities and the county.

The types of assistance might include: ways of involving citizens in the planning process, sustainable urban development strategies, analysis of physical, economic and social trends in the metropolitan area, description of alternative types of planning documents and processes and alternative strategies for implementation of plans.

5) developing an effective voice for local government in national policy and an effective mechanism to share ideas among cities.

Although the national law on local self-government specifically provides for association of cities, no effective organization currently exists. The informal meeting of some cities is taking place with positive reactions from the participants. An opportunity exists to address these concerns of cities by assisting in the formation of an association of cities that would serve the dual purpose of communication of city positions on national policies and sharing ideas and innovations among cities. The type of assistance that might be provided includes such things as: information on similar associations in other countries, workshops of interested cities to develop organizational structure and purpose, and development of program meetings to exchange ideas and information.

Leveraging Other Resources

The RHUDO in Warsaw has several technical resources available to assist in this project, based on USAID's work in Central and Eastern Europe since 1990. These include, but are not limited to, the following:

1. Infrastructure credit application; a model format for developing information to support financing.

2. Manual to develop a program or task oriented city budget.
3. Capital Investment Planning workbook.
4. Solid Waste, Water and Wastewater Operations manuals.
5. Citizen participation in landfill siting.
6. Local environmental management issues.
7. Privatization: Private participation in public services
8. Local economic development tools.
9. Roles of public officials in economic development
10. Media and public relations in local government
11. Case study in the Council/Manager form of government in Poland
12. Asset Management in cities.

These resources, as well as others developed for Eastern Europe, Russia, and the Newly Independent States, will accelerate the assistance to Croatia.

Resident Advisors and Short-Term Assistance

The cities generally are very interested in working with USAID to improve operations. The climate is good for effective technical assistance because the cities have capable personnel and are already working to improve various city functions.

Two long term resident advisors are recommended to implement this project.

It is important to have long-term advisors to develop relationships with the cities that will make the partnerships work. Long term (two years) advisors in municipal management and finance will work collaboratively with city counterparts to address specific problems. Advisors would coordinate project activities, provide technical assistance and maintain contact with cities.

Because of the geographic separation of the cities and the special needs of the Eastern Sector, it would be helpful to locate one advisor in Zagreb and the second advisor in Osijek. The Zagreb advisor could work principally with Zagreb, Rijeka and Split and the second advisor could work

with Osijek and Sector East. Close coordination between the advisors will be important to the success of the project.

As required, short term advisors will be brought in to work on specific topics. Wherever possible, local resources will also be used to assist cities to use and develop resources that will be available even after USAID assistance is completed. The short term advisors can supplement the technical knowledge and workload of the resident advisors and help build the capacity of local resources. It is appropriate for some short term advisors to make repeated visits over the entire term of the project to complete tasks that take more time than a typical two or three week assignment. In addition, continuity in selected short term advisors would facilitate good working partnerships with the cities. Short term advisors could be used for any of the activities described in the recommended areas of concentration. Since additional areas of interest will be identified once resident advisors are in place, short term advisors can also be used to respond to those needs.

In summary, the opportunities for effective collaboration and technical assistance with Croatian cities are substantial. The cities are interested in working with USAID and would benefit by the technical assistance that USAID can offer.

APPENDICES

LIST OF CONTACTS

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LIST OF CONTACTS

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